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Argentina: Challenges Facing the Alfonsin Administration

Special National Intelligence Estimate

Secret

SNIE 91-2-83
6 December 1983

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ARGENTINA: CHALLENGES FACING THE ALFONSIN ADMINISTRATION

Information available as of 1 December 1983 was used in the preparation of this Estimate.

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THIS ESTIMATE IS ISSUED BY THE DIRECTOR OF CENTRAL INTELLIGENCE.

THE NATIONAL FOREIGN INTELLIGENCE BOARD CONCURS.

The following intelligence organizations participated in the preparation of the Estimate:

The Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and the intelligence organizations of the Departments of State and the Treasury.

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KEY JUDGMENTS

President-elect Raul Alfonsin's decisive electoral victory on 30 October marks a sharp departure from the Argentine politics of the last four decades. With a platform combining populist economic programs with pledges to defend human rights, reform the military, and democratize the labor movement, Alfonsin's moderately left-of-center Radical party may have built a new coalition of middle- and working-class Argentines. Alfonsin is deeply committed to the political philosophy reflected in his party's platform but is neither dogmatic nor inflexible.

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While there is some near-term risk to Alfonsin as he takes on Argentina's traditional power brokers—the military, the Peronists, and labor—disarray in their ranks, the strength of his victory, and his apparent willingness to compromise indicate that the opposition will be on the defensive for at least the first six months. Alfonsin's immediate objectives will be to transform his electoral coalition into an effective national political movement; to depoliticize the military through a number of institutional reforms; to democratize Argentina's authoritarian, Peronist-dominated labor movement; and to launch an economic program designed to control inflation, reactivate the economy, and resolve Argentina's major foreign debt problems.

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We believe that Alfonsin will be able to exploit the military's current weaknesses to reassert civilian control over the services and to cut defense spending, but that he will compromise on two issues critical to the military—human rights and corruption. Alfonsin's considerable support from rank-and-file workers should allow him to begin reforming their powerful unions, at least to the point of forcing out several disreputable and corrupt leaders.

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We also expect inflation to drop sharply—both for psychological reasons and because of market trends and new policies—with the restoration of civilian government. This may allow the new President to conclude wage and price settlements that will further lower inflation to a monthly rate of about 5 percent—which would translate into an 80-percent annual rate. At the same time, his plans to stimulate growth by increasing government spending for housing and welfare programs should generate a modest economic recovery during the first six months.

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To ease bankers' apprehensions, Alfonsin and his Economy Minister have already publicly declared their intention to pay all "legitimate" debts. We believe the new government will have ample opportunity to work out a new agreement with the International Monetary Fund and to negotiate Argentina's $40 billion debt. We see considerable room for accord on key questions such as the substantial reduction of the public-sector deficit which Alfonsin has projected. An impasse in the negotiations is unlikely unless the IMF takes an unusually tough stance.

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Beyond mid-1984, however, economic and political pressures will build. Although we believe Alfonsin has the requisite political skills, he will face an increasingly difficult challenge. We expect wage and price pressures to increase and that Alfonsin will discover that his tax restructuring and collection efforts have not generated sufficient funds to cover substantial increases in public spending. If the IMF and international bankers react to a growing deficit by halting disbursements and restricting new lending, the Radicals will have little choice but to rely on monetary expansion, leading to a resurgence of inflationary pressures and laying the groundwork for another wage-price spiral.

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We also expect political opposition to increase after mid-1984, especially if economic performance deteriorates and popular expectations are unrealized. The Peronists, and labor especially, probably will have begun to challenge the new government, and Alfonsin's electoral coalition will begin to fray at the edges in the face of competing demands. While we see no serious threat to Alfonsin from the military during his first year, the armed forces would begin to reassert their strength if they perceive a substantial loss of civilian control and increased social tensions.

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Alfonsin's position on the Falkland Islands dispute differs little from that of his military predecessors, although he is even less likely to use force. On the Beagle Channel dispute with Chile, his substantive position is almost as tough as the military's, but he evidences some tactical flexibility that could provide impetus for a solution. Argentine relations with the USSR and Cuba are not likely to improve substantially under an Alfonsin administration.

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Alfonsin has stated that he seeks improved bilateral relations, but the United States can expect little support from the Radical government on foreign policy issues that touch Alfonsin's anti-imperialist nerve. A nationalist, he will keep Argentina in the nonaligned camp and maintain a strong stand against US military involvement in Central America and the Caribbean.

Nonetheless, Alfonsin does not appear predisposed toward bilateral confrontation, and he recognizes the wisdom of gaining US support for Argentine debt refinancing.

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DISCUSSION

1. The electoral victory on 30 October of Radical Civic Union (UCR) presidential candidate Raul Alfonsin marks a sharp departure from the Argentine politics of the last four decades. Having long placed a poor second behind the followers of Juan Peron in national political contests, the Radicals this time won 52 percent of the popular vote, as opposed to the Peronists' 40 percent. With a populist platform and strong advocacy of democratic government and human rights, the moderately left-of-center Radicals—under the charismatic Alfonsin—may have built a new coalition of middle- and working-class Argentines.

2. Alfonsin's triumph has created high expectations and generated considerable enthusiasm even among traditional opponents. At the same time, however, he inherits a legacy of contentious, seemingly intractable problems that make governing Argentina difficult even in the near term. The economy is in shambles, with enormous foreign debt servicing obligations and inflation soaring at nearly 400 percent annually, and labor, whose leadership has been dominated by rightwing Peronists, has made growing demands on the system. Furthermore, the military has failed to govern effectively or to defend national interests adequately and stands publicly accused of murdering thousands of Argentines during the 1970s antiterrorist campaign.

The Alfonsin Phenomenon

Personality and Ideology

3. The Radicals owe their success in large part to the dynamic and forceful personality of 56-year-old standard bearer Alfonsin. A lawyer from Buenos Aires Province, he is widely considered to be sincere and highly principled. Although Alfonsin has held only one national post—as a congressional deputy in the early 1960s—he is described by most observers as an astute politician with an excellent understanding of Argentine political realities. Alfonsin reportedly identifies with the leftist positions of West European Social Democratic parties and the Socialist International and main- tains close contacts with them.

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He is a fiery, eloquent orator who is at his best when speaking on his favorite themes: the evils of authoritarian rule and the need to root out corruption and promote social welfare

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Winning the Election

4. Alfonsin's presidential nomination last July was the culmination of nearly 10 years of struggle to wrest control of his party from those he saw as middle-class moderates out of touch with the Argentine masses whose thinking was considerably left of mainstream Radical ideology. During the campaign, Alfonsin moved quickly to expand the Radical camp beyond its historical middle-class constituency—his program combined familiar populist economic and social welfare programs with strong advocacy of democratic government, union and military reform, and a strong defense of human rights. He ran an aggressive media campaign against a fractured Peronist party, took his message to every part of Argentina, and battled the Peronists in their own stronghold—the working-class districts ringing Buenos Aires and other major urban areas.

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5. According to political preference polls and other reporting, Alfonsin won with a broad electoral coalition, drawing on what some have dubbed "The New Argentina." Backers included the urban middle class, significant numbers of working-class Argentines who saw the current union leadership as corrupt and too closely tied to the detested military, and conservatives and leftists who opposed Peronism. Alfonsin's triumph did not extend to other party candidates. In the provincial and local elections they could not match the 52 percent of the popular vote their leader drew.

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Implementing Radical Objectives

6. Alfonsin's immediate objective in the weeks following his inauguration will be to transform his diverse electoral coalition into an effective national political movement. He is unlikely to implement an

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early preelection plan to convert his Movement for Renovation and Change into a national organization—largely because many within his own campaign oppose it on the grounds that such a move would smack of Peronism. Alfonsin instead will seek a government of national unity. According to Alfonsin, such a government would have ongoing consultations with interest groups to build a consensus on key issues, especially economic policy. He has already met with moderate Peronist political and labor leaders, and offered defeated Peronist candidate Italo Luder the position of chief justice of the Supreme Court. Other opposition moderates probably will be offered posts in the new administration to promote this concept.

7. Alfonsin will probably strike quickly on a variety of legislative fronts. Recognizing that consensus can be both elusive and short-lived, he most likely will try to implement a program along the lines of the "100 days plan" alluded to in his campaign. Key objectives would be economic and military reform and breaking the grip of old-line Peronist union bosses.

Coping With Peronism

9. ***In the Congress.*** The Peronists and Radicals agree on a variety of issues, but their differences on others could make compromise difficult. The Peronists have enough seats to play an obstructive role. Economic policy and union reform will probably be the major battlegrounds. Moderate Peronists are publicly committed to forming a loyal opposition to protect the concept of civilian government, but they will have to take tough stands on some questions in order at least to appear responsive to their constituency.

10. The ability of the Peronists to exploit their advantage remains in doubt. The loss of the presidential election apparently has stunned the Peronist leadership and thrown the party into disarray.

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Development of new leadership cadres, however, has already proved difficult—given seven years of military rule—suggesting that there will be further delays in structuring a unified, effective opposition.

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11. ***In the Unions.*** One of Alfonsin's principal challenges will be the successful democratization of Argentina's authoritarian, Peronist-dominated labor movement. The new President intends to strip the current labor leadership of its power because he views it as corrupt and at odds with the true interests of the workers. Alfonsin must break its grip if he wants to bring the working class permanently into the Radical camp and to limit labor's ability to mobilize against the government. Alfonsin's Minister of Labor is not influential in the party or among the workers, suggesting that the President intends to be directly involved in union reform.

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12. Judging by his public statements, we expect Alfonsin to:

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- Force the current leadership to stand for reelection in closely supervised contests. (He believes they will lose, thus allowing a more responsible union leadership to take charge.)
- Guarantee the right of workers to join and leave unions freely.
- Allow rival unions to form in each industrial sector and guarantee minority representation on executive boards.
- Appoint judicial overseers to assure the independence of huge union welfare funds that have been used in the past for Peronist political and personal gain.

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13. Alfonsin's strategy to build support for union reform by exploiting existing rifts within the Peronist labor movement offers hope, in our view, for at least partial success. Unlike the proposals of other Radical politicians, he has distinguished his criticism of the labor hierarchy from his support for an independent labor movement. The size of his working-class vote suggests that he has been successful in isolating the leadership from the rank and file and that most union members would support new elections, if not other portions of his labor program.

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Dealing With The Military

14. Alfonsin intends to depoliticize the military, which, having overthrown six elected civilian administrations since 1930, potentially poses the greatest threat to his government. During the campaign he railed against military corruption and authoritarianism, and he accused rightwing commanders—correctly—of colluding with their Peronist trade union counterparts. Furthermore, he has pointed to the Falklands defeat as evidence that the armed forces have lost sight of their external mission and are no longer able to defend national interests.

15. Alfonsin's harshest attack, however, has centered on the military's security and intelligence services, which he believes responsible for the disappearance of thousands of Argentines during the struggle against leftist terrorists in the 1970s—the so-called "dirty war." His platform called for full judicial investigations of human rights abuses and the repeal of the military's decree law of last September, which both granted amnesty to officials and other groups involved in counterterrorist activities and prohibited future inquiries into past counterterrorist excesses.

16. We expect Alfonsin to take advantage of the military's weakness and his electoral mandate to address some of these key issues. According to a variety of sources, in order to achieve his stated objective of democratizing the armed forces by preventing their reentry into national politics, he intends to:

— Introduce structural reforms that will dilute the power of the service chiefs and place a second layer of bureaucracy between the civilian authorities and the military.

— Reassign the military's role in internal security to a special force under the national police jurisdiction of the Ministry of Interior.

— Reduce military budgets by paring weapons purchases and encouraging interservice cooperation to avoid duplication.

— Reduce personnel levels and eventually abolish conscription.

— Use the forthcoming retirement and promotion cycle to ease out rightwing officers and other potential dissidents.

— Eliminate the services' control over state-owned corporations, such as the armaments and shipping industries.

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17. Alfonsin apparently realizes, however, that taking on the military on the sensitive human rights issue, at least in the short term, would galvanize his opponents in the military and cost him good will among second-echelon and junior officers. He probably will move cautiously and has already demonstrated considerable flexibility by modifying his earlier position. He has ceased his blanket condemnations of the security forces and will seek retribution only against those who issued the orders—not the operatives. We believe that Alfonsin will probably also follow through on public statements that he will focus on bringing to justice only high-ranking officers suspected of corruption. Alfonsin could, however, use the threat of blanket investigations of human rights abuses and malfeasance in the short term to gain acquiescence from the military on other issues.

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Economic Policy

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18. During the early months of his presidency, Alfonsin and Economy Minister Bernardo Grinspun will face three formidable economic challenges—controlling inflation, reactivating the economy, and resolving foreign debt difficulties. On the domestic front, they must try first to check inflation while honoring campaign promises for wage hikes and expensive social programs. As they work toward moderating price increases, they will move to fulfill their primary goal of reactivating the economy, which has contracted some 11 percent since 1980 and remained stalled this year.[2]

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19. Grinspun must move to resolve Argentina's de facto payments moratorium and establish a viable repayment plan for some $18 billion in principal, interest, and arrears due in 1984. Ending the current financial stalemate will require the Argentines to negotiate an agreement with the International Monetary Fund, carefully weighing their planned reactivation of the economy against austerity measures we expect the IMF to demand. Their ability to obtain the IMF seal of approval will set the groundwork for reschedulings and new loans from commercial banks

[2] See annex B for a fuller description of the economy in 1983.

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vital to a domestic upturn, but a new IMF agreement may not be forthcoming before March.

20. ***Controlling Inflation.*** The new economic team has yet to frame a detailed inflation policy, but believes that present market and political forces and its initial stimulative policies will pay early dividends. Press reports indicate that Grinspun believes inflation initially will fall to about 10 percent a month—or about 215 percent annually—as the reestablishment of constitutional government under Alfonsin dampens uncertainty and speculation in local financial markets. Alfonsin expects substantial gains from planned increases in productivity to moderate inflationary momentum. He has also predicted that inflation will be further abated by a resurgence of production as existing idle industrial capacity is drawn upon. Grinspun is seeking wage and price control agreements with labor and business that would reduce inflation to a monthly rate of 5 percent within three to four months.

21. ***Domestic Reactivation.*** Alfonsin recognizes that massive efforts to stimulate the economy will be constrained by the shortage of skilled labor, Argentina's obsolete industrial equipment, its deteriorating infrastructure, and an inefficient commercial sector. Press statements indicate that the Radicals will promote growth mainly through demand stimulation policies and the easing of industrial costs. They will push for new and substantial government spending for housing and antipoverty programs. such spending programs would be financed by reducing military spending and implementing badly needed tax reforms and collection efforts. To stimulate private industry, he will resort to subsidized interest rates to reduce business costs in addition to generating new investment. Grinspun has said that real wage increases will be limited to 6 percent yearly and then only if supported by corresponding productivity gains.

22. Alfonsin's attempts to stimulate the economy are certain to prove popular and at least create an impression of renovation and change. Businesses will be pleased initially with subsidized interest rates and reductions in military spending that should make more credit available to the private sector. Similarly, support for more housing, higher real wages, and antipoverty programs should encourage wage earners.

23. ***Foreign Debt.*** We expect Grinspun to become directly involved in negotiations on the $40 billion foreign debt, but he will need two to three months to work out internally consistent economic policies before formally presenting a program to the IMF. Argentina is already far out of compliance with its IMF program, and Grinspun will have to forge a completely new agreement with the Fund to hold the debt restructuring effort together. Although party campaign promises will lead Grinspun to resist publicly tough austerity measures that would preclude public works and investment programs designed to restart the economy, his recent statements demonstrate pragmatism in handling debt issues.

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24. Grinspun has indicated that, subsequent to the IMF negotiations, he will go to commercial banks to discuss rescheduling and a new loan in order to settle past-due payments and to free some export earnings for the purchase of imports needed to reactivate industry. In an effort to address bankers' concerns, he and Alfonsin have already publicly declared their intention to pay all "legitimate" debt [3] to the extent that payment inflicts no serious hardships on the public.

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25. Grinspun has pinned his hopes for meeting future debt servicing on Argentina's impressive ability to export. In addition to encouraging the production of manufactured goods and other nontraditional exports by subsidies and continued devaluations, he hopes to spur foreign grain sales by facilitating flows of credit, fertilizer, and other inputs to the agricultural sector.

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26. We believe that Alfonsin and his economic team do not favor a debtors' cartel, but will lobby for easier repayment terms. The press notes that unnamed advisers to Alfonsin favor a drop of one-eighth of a percentage point in interest rates and a two-year extension of the payback period. The new Central Bank President commented in a preelection interview that an Alfonsin government would seek one year of grace on international debts to allow reactivation of the economy before further payments were made.

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[3] By legitimate debt, Argentines mean obligations owed to foreign creditors. In the past, individuals and firms were known to present false financial records of external obligations to obtain foreign exchange at preferential rates from the Central Bank. To ease the debt-servicing burden, Alfonsin wants to identify and curtail such operations, which are estimated by some Argentine economists to account for as much as one-fourth of the total external debt.

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Calls for a debt repudiation—not supported or encouraged by the Radicals—have faded with the departure of ultranationalist Air Force officers from economic decision making.

27. Alfonsin's past criticism of multinational corporations for their economic imperialism probably will deter some foreign investors, at least initially. The new President has indicated that he would welcome foreign investment that is beneficial to Argentina, but we expect him to control it carefully. The most probable development is a new foreign investment law that would be a compromise between the unrealistic constraints contained in the 1973 Peronist legislation and the very relaxed conditions established by the military since 1976.

Foreign Policy

28. Alfonsin shares the nationalism of his military predecessors and has publicly applauded the armed forces' move away from unconditional support for the West in the wake of the Falklands defeat and toward stronger ties with Latin American and other Third World countries. We believe the new President will retain several other of the military's general foreign policy precepts, including:

— Strong support for most objectives of the Nonaligned Movement.

— Advocacy of superpower nuclear disarmament.

— Opposition to the Nuclear Non-Proliferation Treaty, and ratification of the Tlatelolco Treaty only if the right to conduct peaceful nuclear explosive tests is recognized.[4]

29. Alfonsin's position on the Falklands dispute reflects no discernible change in tone and little in substance from that of the military. He will maintain a tough stand, but has said he would not condone harassment of the British garrison. His public pronouncements also indicate that he believes the islands are an integral part of Argentine territory and any formal cessation of hostilities with the United Kingdom would have to be part of an overall plan to resume negotiations on sovereignty.

30. On the Beagle Channel dispute with Chile, Alfonsin differs from the military in that he intends to accept the 1980 papal mediation proposal—without the prior concessions the military had demanded—as the basis for a final agreement. He will back the military's position that there must be adjustments in the final settlement that confirms Argentina's preeminence in the Atlantic.[5] Alfonsin may seek early resolution of this dispute, which would boost both his domestic standing and his foreign political stock.

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Attitude Toward the United States

31. Alfonsin has stated publicly and privately that he seeks better relations with the United States, but there are potential areas of contention, particularly given his personal preferences and understanding of Argentine national interests. He has described himself as anti-imperialist and has blamed the United States—more than the Soviets—for much of the world tension. Alfonsin has been especially critical of the US role in Central America and has strongly condemned US actions in Grenada. He has also criticized Washington for its stand on the Falklands and for not opposing British plans to build a major base on the islands. In addition, he has attacked Western—primarily US—banking interests, accusing lenders of contributing to current economic woes and charging outrageous commissions, fees, and interest rates for new loans to meet debt-servicing obligations.

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32. Alfonsin might be receptive to some initiatives, but he cannot openly identify with the United States. Argentina's desire for Washington's support on debt refinancing will encourage at least low-profile cooperation. He would welcome assurances that Washington would not condone any military moves against his government.

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Attitude Toward the USSR and Cuba

33. In our view, the constraints that limited bilateral relations with the Soviet Union under the military regime are likely to apply to the Alfonsin administration.[6] While we expect improvements to continue

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gradually, much as before the election, [redacted] Alfonsin shares the deeply rooted anti-Communist views of the military and the Peronists and their suspicions of Moscow's intentions in Latin America. Nevertheless we expect the Soviets to continue to press for trade concessions to reduce the huge trade imbalance resulting from grain purchases. Alfonsin is likely to be responsive where possible to protect this vital market, but we do not see commensurate gains in Soviet political influence. We believe, moreover, that the new administration will be disinclined for ideological and financial reasons to purchase Soviet weaponry. [redacted]

34. Cuba publicly expressed delight with Alfonsin's election, but, in our view, Havana will move cautiously in strengthening ties with the new government. Castro is likely to probe the administration for positions on key issues—especially Central America and the Caribbean—and build common policies where possible. We do not believe he will provide any direct support to radical leftists, but will maintain contacts to keep his longer term options open. Alfonsin most likely will be equally circumspect, for the most part continuing the military's policy of cooperation where possible to assure Cuban backing on Falklands-related initiatives and to maintain Argentina's credentials among Third World countries. Trade will be based upon already existing credits extended to Havana. [redacted]

Outlook

The First Six Months

35. The strength of Alfonsin's electoral mandate, his personal attributes, and the problems facing his opponents argue that the new Radical government will not be seriously threatened during its first six months in office. The President-elect drew strong support from almost every class and geographic region in Argentina, and this will make it difficult for even his staunchest opponents to challenge him. The President's stated intentions to form a government of national unity and to consult on key issues should keep opponents on the defensive for some time. Moreover, we expect a bitter internal power struggle to occupy the Peronists for at least the next several months, perhaps leading to formal splits in their movement. [redacted]

36. We believe the armed forces will be reluctant to move against the government for at least six months, although the military's fractured, feuding state almost ensures that reports of conspiracies will surface periodically. Historically, the armed forces have not intervened without popular acquiescence, and we judge that they will remain wary of confronting Alfonsin in light of his overwhelming win. Only in the unlikely event that Alfonsin recklessly moves to a confrontational strategy on the human rights issue would he face a threat from the military during the first six months of his term. [redacted] 25X1 25X1 25X1

37. The first major challenge to Alfonsin's policies is likely to come from labor, especially from the old-line bosses who will resist reform and stir factional violence. We doubt, however, that labor agitation would pose any real threat to the government during the first months of the new administration. [redacted] 25X1 25X1

38. Alfonsin's economic team should enjoy some immediate economic successes that will also blunt opposition to the government. Inflation is likely to drop sharply as the civilians come into power, largely because wages and prices were raised sharply in the immediate preelection period in anticipation of wage and price controls following the election. As speculation eases and price agreements take effect, inflationary momentum will tend to slow. Grinspun's goal of a 5-percent monthly inflation rate should be attainable, at least initially, especially if Alfonsin can capitalize on the initial honeymoon period to strip away some of the psychological pressures behind inflation. Free-market rates of exchange since the election indicate that inflationary expectations already are diminished. [redacted] 25X1 25X1

39. Argentina's external payments difficulties should also abate temporarily. Foreign grain sales—scheduled to resume this month—will generate new flows of foreign exchange that can help clear up debt arrears and lead to the removal of the exchange restrictions currently constricting imports. We also expect that lenders will be willing to allow small reductions of the interest rate spread and extended grace and payments periods because of the precedent established by Brazil's bank advisory committee and the privately reported desire of bankers to cooperate with the new government. [redacted] 25X1

40. There is a small risk, however, that the performance criteria in any new IMF program could stall a quick reconciliation. We judge that there is ample room for reduction of the Argentine deficit—likely to 25X1

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be at least 15 percent of gross domestic product in 1983—and Grinspun's optimistic plans to keep the deficit to 5 percent of GDP will prove satisfactory to the Fund. Contention over Grinspun's plans for import and capital controls and export subsidies, however, may well delay an agreement and stall access to IMF funds, contributing to persistent cash-flow difficulties. The probability of a moratorium or a declared default would increase under this scenario.

41. Even if past-due loans are rescheduled and a new IMF program to gain access to new bank loans is established, as much as $3 billion in additional credit will be required by Buenos Aires to clear past-due debts and obtain imports to nourish a recovery in 1984. Any agreement Grinspun signs, however, has the potential to cause trouble. Unless presented to the public as a growth program with which the banks are assisting, it could trigger a backlash, fueling demands for a long-term moratorium.

A Tougher Second Six Months

42. In spite of a somewhat hopeful beginning and a few initial successes, we expect Argentina's economic difficulties and attendant political problems to increase substantially around mid-1984. Alfonsin's economic policies will probably generate problems with the IMF, which is likely to oppose some spending programs and press for reduced economic intervention. Commercial banks will follow the Fund's lead in demanding adjustment policies in return for new loans necessary to sustain the upturn.

43. Domestically, Alfonsin is likely to find that tax restructuring and collection efforts have not generated funds needed to support economic reactivation while keeping the deficit to 5 percent of GDP. If he then continues to push higher public investment, more spending for housing, higher salaries, and new social welfare programs, he will face a growing government deficit, and the IMF probably would halt disbursements under any new loan programs. Without foreign borrowing, the Radicals would have little choice but to rely on monetary expansion, setting inflationary forces at work against price controls.

44. On the basis of a sharp jump in the deficit and attendant monetary expansion this year, we anticipate a resurgence of inflationary pressures by mid-1984, even if Grinspun forges a consensus to limit price and wage increases. Such a resurgence would ultimately undermine labor cooperation on wages. If labor support evaporates, the foundation will be laid for another wage-price spiral.

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45. The initial happiness in business circles with below-market interest rates will wane by midyear if they trigger renewed capital flight and undermine capital formation. Moreover, the domestic debt relief flowing from these policies could be quickly overwhelmed by wage increases. With tight price controls, profit margins would then be squeezed and bankruptcies would increase. Resulting rises in unemployment would gut the purchasing power initially gained by wage earners. Real wages would be further squeezed by higher prices as supplies of goods shrink, and stagflation would then be likely to emerge by late 1984.

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46. Mounting political pressures will also begin to take their toll, especially if the economy deteriorates. Alfonsin's ability to hold his coalition together in the face of conflicting demands could prove difficult. Mainstream Radicals have already criticized his efforts to accommodate ideological extremists within the party and his plans to form a national movement similar to Peronism. Human rights groups have vowed to press for full-scale investigations of abuses. Conservative allies in the Senate may break with Alfonsin on key legislation. Peronists will almost certainly exploit these rifts to try to consolidate their own following. Although the Peronists are not likely to try to bring down the new government, a reinvigorated Peronist movement would greatly complicate policymaking. Similarly, the military, in the face of greater social and political turmoil, would begin to reassert its strength in key policy areas.

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Implications for the United States

47. The United States can expect little support from the Radical Civic Union government on several important regional and international issues. Alfonsin is a strong supporter of the Contadora initiative, and his administration will continue to maintain a tough stand against US military involvement in Central America and the Caribbean. We also expect Alfonsin to move forward with publicly articulated plans to promote Latin American regional organizations, especially in

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the area of economic development, that exclude the United States. Relations with Washington might also be complicated by Alfonsin's apparent plans to encourage regime changes in neighboring states. Alfonsin will probably encourage, if not openly support, their efforts.

48. On the other hand, on most political and security interests involving the USSR and Cuba, Washington's interests and those of the Radical government are likely to overlap. Alfonsin's desire to resolve territorial disputes with Chile and the United Kingdom also coincides with US interests. If he is able to bring about a swift resolution to the Beagle Channel dispute with Chile, it would remove a longstanding potential flashpoint in the hemisphere. Moreover, although he will take a tough negotiating stand on the Falklands, he has refused to condone renewed military harassment of the British garrison.

49. A significant warming trend in US-Argentine relations in the short term would pose some risk for US relations with the United Kingdom.

50. Prime Minister Thatcher is even more concerned, however, that expanded ties could signal renewed arms sales to the Argentine military. While London understands the need to certify the new government on human rights, the Prime Minister strongly opposes renewed arms sales, particularly if such transfers are not preceded by a formal cessation of hostilities. In our view, London is most concerned about sales of advanced weaponry, technology, and fighter aircraft, and would probably be less worried about other equipment, such as helicopters or older airframes that did not qualitatively enhance the Argentines' capability to reinvade the islands.

51. A breakdown in Argentina's debt renegotiations would have serious implications for US banks. At the beginning of 1983, Buenos Aires was the fourth largest debtor to the United States, with some $8.2 billion outstanding to US lending institutions. A long-term moratorium, or a selected default, would quickly push some Argentine loans into nonperformance, seriously eroding the profits of some banks and perhaps raising the necessity of a government bailout or mergers to keep others afloat.

52. We consider such radical actions to be unlikely, at least during the first six months of the Alfonsin administration, but Grinspun is an unproven debt negotiator and has a reputation among bankers as aggressive and undiplomatic. If negotiations reached an impasse, Argentina might become a major debtor around which smaller Latin American nations, which are again trying to develop a joint debtors' negotiating position, could coalesce. Should such a bloc push for a long-term moratorium, the resulting damage to the financial integrity of a large number of banks worldwide could set off a major international financial crisis.

Indicators of Instability

53. Although we believe that President-elect Alfonsin's first six months in office will be relatively quiet, there are near-term risks inherent in his plans to take on Argentina's traditional power brokers. These risks, in our view, increase after midyear. The following list provides policymakers and analysts with indicators we believe would point to an erosion of Alfonsin's position. The indicators are listed from the least to the most critical for the well-being of Alfonsin's administration, and they are roughly in the order we would expect them to occur:

- Alfonsin backs away substantially from plans to consult opposition on key policy issues.
- Rifts among Peronists heal quickly, and the movement begins to respond to a recognized leadership.
- Congressional opposition begins introducing legislation to embarrass the government and stalls key administration initiatives.

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— Alfonsin's electoral coalition fails to coalesce in the face of conflicting demands; Radicals take initiatives in Congress contrary to Alfonsin's wishes.

— Escalating criticism of Alfonsin by his supporters is reflected in the media.

— Rank-and-file workers resist calls for new union elections or reelect old leadership.

— Alfonsin fails to reach agreement on wages and prices with labor and business.

— Alfonsin fails to reach agreement with international lenders.

— Second-echelon and junior military officers judge that Alfonsin's reforms threaten the military as an institution.

— Renewal of the inflationary spiral as austerity programs fail.

— Labor pressure mounts; general strikes occur both for wage hikes and to undermine the government.

— Rightist and leftist terrorism reemerges and escalates.

— Military right wing renews contacts with Peronist counterparts.

— Military opposition to Alfonsin coalesces across service lines.

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ANNEX B

THE ECONOMY IN 1983

After the economic chaos triggered by the Falklands conflict, Argentina began the year on a hopeful note. A default had been staved off by a $1.1 billion commercial bank bridge loan and a $2.2 billion International Monetary Fund rescue program aimed at reducing inflation from about 210 to 160 percent while generating 5-percent real growth. Moreover, a $1.5 billion new money loan was scheduled in the second half of the year to cover foreign financing requirements. A rebound in export earnings to $9.5 billion was expected to lead to an improved balance-of-payments performance. The Alfonsin government, however, will inherit nearly 400-percent yearly inflation, negligible growth, and stalled bank and Fund loan arrangements.

Inflation was never brought under control as demands for sharply higher salaries in January kept the wage-price spiral in motion. Consumer price growth will probably reach more than 400 percent for 1983, introducing distortion throughout the economy. Such rapid price jumps reduced the incentive for production and new investment while encouraging efforts at speculation. Despite some initial improvements in industrial capacity utilization and other indicators of recovery such as electricity use, economic growth will probably be on the order of 1 percent for the year. Moreover, price rises also generated large wage demands, especially in the public sector, augmenting an extraordinary expansion of the government deficit which itself fueled inflation.

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The financial rescue program soon ran into difficulties as a result of a dispute with bankers over domestic legal issues affecting the debt, ultimately forcing Argentina into a de facto payments moratorium. Initially, Buenos Aires was unable to access promised loans needed to eliminate its interest arrears on foreign debts by the end of June as agreed upon with the Fund, thus stalling bank and IMF loan drawings. Despite having drawn foreign reserves down to dangerously low levels in September to make external payments, Argentina still has substantial interest arrears. Past-due payments

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triggered another series of delays in the disbursement of loans. Although the Argentines were able to make more than $3 billion in interest payments during the year, they will need to negotiate another IMF program largely because the military government's inability to deny unrealistically high wage demands caused the collapse of fiscal discipline. Noncompliance with IMF targets is likely to make it impossible to draw some $620 million in remaining 1983 Fund credit and to force new negotiations for bank loans of at least $1 billion.

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